DEPARTMENT OF STATE REVENUE

04-20191060R.ODR

Final Order Denying Refund: 04-20191060R
Gross Retail and Use Tax
For the Year 2015 and 2016

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Order Denying Refund.

HOLDING

Insurance Company was not entitled to a refund of sales tax paid on the purchase of prewritten computer software purchased from various vendors and utilized in part by Insurance Company's Indiana employees; Insurance Company was not entitled to a refund of tax paid on the purchase of software maintenance agreements because Insurance Company failed to establish the underlying software was exempt or that the agreements did not call for the provision of updates, patches, or "fixes."

ISSUES

I. Gross Retail and Use Tax - Prewritten Computer Software.

Authority: IC § 6-2.5-1-27; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-3-2(e); IC §§ 6-2.5-5 et seq.; IC § 6-2.5-13-1(d)(1); IC § 6-2.5-13-1(d)(2); *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Rhoade v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); 45 IAC 2.2-3-14(2); 45 IAC 2.2-3-16 (repealed); 45 IAC 2.2-5-3(b); 45 IAC 2.2-5-6(a); 45 IAC 2.2-5-8(a); 45 IAC 2.2-5-9(a); 45 IAC 2.2-5-10(a); Sales Tax Information Bulletin 8 (November 2011); Sales Tax Information Bulletin 8 (December 2016); Sales Tax Information Bulletin 8 (July 1, 2018).

Taxpayer argues that the Department erred in denying it a refund of tax paid on the purchase of computer software claiming that the software was accessed and used by many of its employees located outside Indiana and - in some instances - housed on computer servers located outside the state.

II. Gross Retail and Use Tax - Software Maintenance Agreements.

Authority: IC § 6-2.5-1-14.5; IC § 6-2.5-4-17; *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); Sales Tax Information Bulletin 8 (November 2011).

Taxpayer maintains that it is entitled to a refund of sales/use tax paid on the purchase of software maintenance agreements on the ground that the software is utilized both within and without Indiana or that the maintenance provider did not supply computer updates, fixes, or any other tangible personal property during the term of the agreement.

STATEMENT OF FACTS

Taxpayer is an out-of-state company which provides various insurance products such as individual policies, retirement plans, and group insurance policies. Taxpayer submitted a refund request seeking the return of approximately $150,000 of sales tax paid on the purchase of computer software and maintenance agreements.

The Indiana Department of Revenue ("Department") reviewed Taxpayer's claim and denied the refund.

Taxpayer disagreed with Department's decision denying the refund and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Final Order Denying Refund results.

I. Gross Retail and Use Tax - Prewritten Computer Software.

DISCUSSION

The issue is whether Taxpayer has established that it was entitled to an apportioned refund of sales tax paid on the purchase of prewritten computer software on the ground that the software was hosted by vendors on computer servers located outside Indiana and accessed by Taxpayer's employees who were located both within and outside the state.

A. Taxpayer's Burden in Claiming a Refund.

When a taxpayer challenges taxability in a specific instance, the taxpayer is required to provide documentation explaining and supporting its challenge. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014).

B. Indiana's Gross Retail Tax.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). "When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location." IC § 6-2.5-13-1(d)(1). "When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser . . . occurs . . . ." IC § 6-2.5-13-1(d)(2).

C. Indiana's Complementary Use Tax.

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a).

In effect and practice, the use tax is generally functionally equivalent to the sales tax. See *Rhoade v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002). However, Indiana's use tax - not sales tax - allows an exception for the "temporary storage" of tangible personal property delivered into Indiana but destined for use outside the state. IC § 6-2.5-3-2(e).

D. Computer Software and Indiana's Sales/Use Tax.

IC § 6-2.5-1-27 incorporates "prewritten computer software" in the definition of tangible personal property subject to sales/use tax:

> "Tangible personal property" means personal property that:
> (1) can be seen, weighed, measured, felt, or touched; or
> (2) is in any other manner perceptible to the senses.
> The term includes electricity, water, gas, steam, and prewritten computer software.

A person who acquires property in a retail transaction (a "retail purchaser") is liable for the tax on the transaction. IC § 6-2.5-2-1(b).

E. Sales and Use Tax Exemptions.

As a general rule, all purchases of tangible personal property - including computer software - are subject to sales or use tax unless specifically exempted by statutes or regulations. 45 IAC 2.2-5-3(b); 45 IAC 2.2-5-6(a); 45 IAC 2.2-5-8(a); 45 IAC 2.2-5-9(a); 45 IAC 2.2-5-10(a). Various tax exemptions are outlined in IC §§ 6-2.5-5 et seq. which are applicable to both sales tax and use tax. 45 IAC 2.2-3-14(2).

A statute which provides any tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id*. at 101 (internal citations omitted). In applying any tax exemption, the general

rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

Taxpayer purchased prewritten computer software from various vendors such as Dell Software, Inc., IBM Corporation, and Cyber-Ark Software, Inc., to conduct its business. Taxpayer maintains that it did not purchase "software" from these vendors but that it was simply purchasing computer based "services" entitling it to a refund of sales tax paid on these purchases. According to Taxpayer the software was accessed by its Indiana employees and by its out-of-state employees thereby entitling it to apportion the sales tax liability.

Taxpayer maintains that "prewritten computer software maintained on computer servers outside of Indiana is subject to tax when accessed electronically via the Internet." As authority for its position, Taxpayer cites to the Department's Sales Tax Information Bulletin 8 (December 2016), 20170125 Ind. Reg. 045170026NRA.

> Charges for accessing prewritten software maintained on [a] vendor or third party's computer servers are not subject to tax when accessed electronically via the Internet if the customer is not transferred the software, does not have an ownership interest in the software, and does not control or possess the software on the server.

According to Taxpayer, this Bulletin supports its position that "[p]rewritten software maintained on computers outside of Indiana that are not accessed electronically in Indiana . . . are not subject to Indiana tax." However, in the case of the transactions which took place prior to July 1, 2018 and regardless of ownership interest, sourcing rules, or delivery location the Department's guidance on this issue is found at Sales Tax Information Bulletin 8 (November 2011), 20111228 Ind. Reg. 045110765NRA, which was in effect at the time of the pre-December 2016 transactions and is dispositive of software issues raised here by Taxpayer.

> Prewritten computer software maintained on computer servers outside of Indiana also is subject to tax when accessed electronically via the Internet (i.e., "cloud computing"). The accessing of prewritten computer software by Indiana residents constitutes a transfer of the software because the customers gain constructive possession and the right to use, control, or direct the use of the software. Sales Tax Information Bulletin 8 (November 2011).

Sales Tax Information Bulletin 8 (July 1, 2018), 20180725 Ind. Reg. 045-180312NRA, is clear on the application of the 2011 and 2016 Bulletins:

> [T]ransactions involving remotely accessed software occurring prior to July 1, 2018, will need to be analyzed using guidance published in the prior version of this bulletin.

For example, Taxpayer paid approximately $197,387 to IBM Inc. for software which Taxpayer labels as "located outside Indiana." Taxpayer maintains that it is entitled to a refund of 86.19 percent of the sales tax paid because 86.19 percent of the employees accessing the IBM software are located outside Indiana. Presumably 13.81 percent the employees accessing the software are located in Indiana.

In support of its argument, Taxpayer provided copies of vendor invoices along with Internet pages referencing its vendors' computer software and services. On reviewing the invoices and Internet pages, the Department must conclude that the documentation is insufficient to conclusively support Taxpayer's argument because there is little information which is specific to any particular of the 60 some individual transactions.

As further support for its calculation, Taxpayer include a statement from its executive vice-president stating that the vice-president had consulted Taxpayer's human resource department and found that 86.19 percent of employees accessing this software were located outside Indiana.

The Department questions whether the taxable value of the software can be "sliced and diced" based on the geographically proportionate location of the ultimate users of that software when Taxpayer typically paid a unitary price for each software package. Merely because the software is ultimately accessed by users in multiple locations, the Department finds no support for the proposition that Taxpayer can now reallocate the unitary sales tax charge for software based on the ultimate number of software users located within and outside Indiana.

In this case, the bulletin is clear; remotely accessed computer software is "tangible personal property" and subject to Indiana's sales/use tax. Equally clear is IC § 6-2.5-13-1(d)(1) which provides that "[w]hen the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location." In this case, the Department does not agree that Taxpayer has established that payments to the software vendors are

exempt from Indiana's sales tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Gross Retail and Use Tax - Software Maintenance Agreements.

DISCUSSION

The issue is whether Taxpayer has provided sufficient documentation to establish that it is entitled to a refund of sales tax paid on the purchase of software maintenance agreements.

Taxpayer seeks a refund of sales tax paid on the purchase of software maintenance agreements. Taxpayer explains that the maintenance agreements were purchased to service particular software and that this software is accessed by employees located within Indiana and outside Indiana. As with the software described in Part I above, Taxpayer maintains that it is entitled to an apportioned amount of the sales tax paid on these maintenance agreements.

IC § 6-2.5-1-14.5 defines "Computer software maintenance contract" as "a contract that obligates a person to provide a customer with future updates or upgrades of computer software."

Indiana law, IC § 6-2.5-4-17, further provides:

> A person is a retail merchant making a retail transaction when the person enters into a computer software maintenance contract to provide future updates or upgrades to computer software. (*Effective July 1, 2010*).

However, Sales Tax Information Bulletin 8 (November 2011) provides that a taxable maintenance agreement is necessarily coupled with the transfer of "tangible personal property."

> The term "computer software maintenance contract" means a contract that obligates a person to provide a customer with future patches, updates, upgrades, or repairs of computer software.

Taxpayer has not provided information necessary to determine that - during the term of the subject maintenance agreement - the vendors provided no software updates, patches, or "fixes." For example, Taxpayer has not provided copies of the written agreements between itself and the agreement vendors in order to determine whether the agreements do or do not call for software updates. In addition, the Department finds no support for Taxpayer's argument that it can parcel out its sales tax liability based on the location of employees accessing the software subject to the agreements.

The Department is mindful of the rule that "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 101 (Ind. Ct. App. 1974. The Department is unable to agree that a taxpayer's assertion as to the taxability of its maintenance agreements is sufficient to warrant granting a refund of use tax when there is no documentation to buttress that assertion, and the Department does not agree that the sales can be apportioned in the manner Taxpayer suggests.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

For the reasons discussed above, Taxpayer's protest of both Issue I and II is denied.

December 31, 2019

Posted: 04/01/2020 by Legislative Services Agency
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